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	10	GC		X		
	11	IG		X		
	12	Compt		X		
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EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

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October 23, 1985

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MEMORANDUM FOR HEADS OF EXECUTIVE DEPARTMENTS AND AGENCIES

FROM: JOSEPH R. WRIGHT, JR.
DEPUTY DIRECTOR

SUBJECT: Financial Integrity Act Reports

This year's reports to the President and Congress required by the Financial Integrity Act should reflect the tremendous progress that has been made under Reform '88 in upgrading internal controls and modernizing financial systems.

We have made a good start in implementing the Financial Integrity Act and we must not let up now. This year's report should stress three basic elements: (1) the extent to which you have incorporated the Act's requirements into your regular management system, (2) any material weaknesses found in your reviews, and (3) your success in correcting those weaknesses and plans for future action.

The guidance furnished on September 26, 1983, and November 16, 1984, is still valid, and should be used in conjunction with the attachments to this memo to prepare the 1985 reports required by the Act. Attachment 1 covers preparation of the internal control statement and Attachment 2 covers preparation of the report on accounting systems.

The Financial Integrity Act challenges us to show how well we can control and manage Government programs. Your continued attention and support for the work required by the Act will demonstrate that we can meet that challenge. Along with other initiatives under the President's Management Improvement Program, it will result in the kind of modern, business-like management of Government that the taxpayers deserve.

If you or your staff have questions about this guidance or the content of this year's reports, please contact our Financial Integrity Task Force at 395-6823 or 395-3993.

Attachments

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Attachment 1

REPORTING ON INTERNAL CONTROLS UNDER THE FINANCIAL INTEGRITY ACT

The year-end statement on internal control should describe the current status of agency systems and plans for improving them. The most important elements of the evaluation, improvement, and reporting process are:

- o Incorporating internal controls into the agency's basic management structure. The experience gained from three years of operation under the Act, together with the advice received from OMB, the agency's Inspector General, and the General Accounting Office should be considered in updating and describing this process.

- o Identifying and reporting on material control weaknesses. Candor in reporting these weaknesses to agency management and in reporting them to the President and the Congress is of utmost importance. While there continues to be some uncertainty as to what constitutes a material weakness, the definitions developed by individual agencies have been helpful in defining it in terms appropriate for the agency's operations. In addition, the House Committee on Government Operations has provided some sound advice on this matter. It suggested, and we agree, that agency officials should include as material weaknesses those matters that could:

  - Impair fulfillment of the agency's mission;

  - Deprive the public of needed government services;

  - Violate statutory or regulatory requirements; or

  - Result in a conflict of interest.

- o Tracking and correcting the control system weaknesses. This is the most important single aspect of the internal control process. It includes periodic tracking and high level management review to ensure that timely corrective action is taken. Thereafter, appropriate management review is needed to assess the actions taken to determine whether the weaknesses have been corrected.

In preparing the internal control statement, each agency should use the sample statement furnished in OMB's Internal Control Guidelines and in the memorandum on this subject dated September 26, 1983—to the extent appropriate for its situation. Most agencies have followed this guidance in preparing their statements on the first two years' operations. Agency officials also may find it useful to examine the statements issued by others to determine how certain problem issues were reported. Copies of the internal control statements are on file in OMB for examination by agency officials.

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While we believe the most important elements of the internal control statement deal with the three subjects discussed above, the overall conclusion as to whether the objectives of internal controls are being achieved, for the agency as a whole, is also important. All available information should be considered by the agency head in reaching that conclusion. This includes:

- o Internal control evaluations;
- o Audits by the Inspector General, GAO, and others;
- o Internal reviews, inspections, management studies, etc., made by agency staff or contractors to assess operations;
- o The control system weaknesses found, corrected, or being corrected;
- o Seriousness of the existing weaknesses and extent that the control systems are believed to be working as intended;
- o The assurances given by agency officials that the control systems are working as intended; and
- o The system improvements made in recent years.

Thus, all information available to agency management is to be considered in making the reasonable assurance determination for use in the year-end statement. It is also important that the agency's statement discloses its material system weaknesses, and provides a plan and schedule for corrective actions.

The General Accounting Office has challenged the statements of some agencies that they have reasonable assurance that their system of internal control meets the objectives of the Act. In doing so, GAO suggested that, unless most of an agency's control systems are evaluated and tested, and until the recommended improvements in the evaluation process are made and the material weaknesses are corrected, the agency head does not have an adequate basis to provide a reasonable assurance statement. We disagree with this approach and have advised the Comptroller General of our objection. A copy of our August 26, 1985, letter to the Comptroller General is attached.

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Attachment A to the internal control statement is to contain a detailed description of the agency's evaluation process and plans to incorporate it into basic management operations. This information has proven useful in explaining an agency's process and accomplishments in implementing the internal control requirements of the Act. As such, it should continue to be included as part of each internal control statement. For the 1985 statement, however, the attachment should also include a summary of accomplishments during the year on each of the following items:

- Evaluation of payment systems, accomplished in accordance with OMB Memorandum 85-7, dated November 7, 1984;

- Evaluation of information technology systems (sensitive applications and ADP facilities) to meet the requirements of Circulars A-71, A-123, and A-127; and

- The agency's program for review of actions taken to determine whether the material control system weaknesses have been corrected as intended.

If programs to accomplish each of these tasks have not been established, then describe the 1986 plan to do so.

Reporting on material weaknesses, submission of plans and schedules for corrective actions, and reporting on the status of actions to correct the weaknesses reported in prior years are to be accomplished using the instructions previously issued.

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EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

AUG 26 1985

Honorable Charles A. Bowsher
Comptroller General of the
United States
General Accounting Office
Washington, D.C. 20548

Dear Chuck:

We are concerned by what appears to be a recurrent theme in the draft reports issued by your division directors concerning the agencies' implementation of the Federal Managers Financial Integrity Act. The theme is that the agencies' internal control evaluation and improvement process has not accomplished enough for the agency heads to have an adequate basis to report that their system of internal control, for the agency as a whole, provides reasonable assurance that the objectives of internal control are being achieved within the limits described in their statements.

Many of the reports suggest that (1) unless most of the agencies' control systems are evaluated and tested, and (2) until the recommended improvements to the evaluation process are made and the material weaknesses in the control system are corrected, then the agency head does not have an adequate basis to provide a reasonable assurance statement. Such an approach suggests that GAO is looking for a higher level of assurance than the reasonable assurance requirement provided for in the Act. If we look for absolute assurance it would be impossible for any organization, government or business, to meet such a test.

In the reports issued by the National Security and International Affairs Division the agencies are advised that:

> "In determining whether an adequate basis exists for reporting that systems of internal accounting and administrative controls meet the objectives of the act, we believe the agency head must consider the (1) significance of the weaknesses disclosed, (2) status of corrective actions, (3) comprehensiveness and quality of the management control evaluation work performed, and (4) extent to which accounting systems conform to the Comptroller General's principles, standards, and related requirements."

We agree with this summary as far as it goes, but are concerned with the limitations that seem to be included in item (3), since many of the reports equate this only with the agencies' internal control evaluation process. In an exchange of correspondence with GAO last winter, copy enclosed, we advised that an agency head is expected to consider more than the results of the internal control evaluation process. We believe that the sum of all information available to management (including the assurance letters received from managers, all known internal control weaknesses, and the effect of IG reports, GAO reports and other work done within the agency) is to be considered in making the reasonable assurance determination for use in the year-end internal control statement.

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Similarly we object to the idea that there is minimum evaluation criteria for agencies to achieve before they have an adequate basis to provide a reasonable assurance statement. We have not established such a level, nor do we believe it realistic to do so. By suggesting that until most of the control systems are tested and the weaknesses corrected an agency can not have an adequate basis for a reasonable assurance statement, GAO is encouraging the agencies to undertake a level of evaluative work significantly beyond what was contemplated by the Act.

The many recommendations being made for improving the evaluation process are constructive, as are those for assuring effective corrective action. We are encouraged to find that only in isolated instances were material internal control weaknesses omitted from the agency reports. By concentrating on the substance of the evaluation process, the reporting of material weaknesses and taking corrective actions on them, but with less emphasis on wording of the agency head's conclusion, we can work together more effectively with agency managers to achieve our mutual objective of improving internal or management control throughout Government.

Sincerely,

Joe

Joseph R. Wright, Jr.
Acting Director

Enclosure (Omitted)

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Attachment 2

REPORTING ON ACCOUNTING SYSTEMS UNDER THE FINANCIAL INTEGRITY ACT

The guidance furnished during FY 1985 about the evaluation, improvement, and reporting on financial management/accounting systems provides the foundation for reporting under Section 4 of the Financial Integrity Act. This guidance includes: (1) OMB Circular A-127, "Financial Management Systems," dated December 19, 1984; (2) Memorandum 85-10, "Financial Management and Accounting Objectives," dated March 15, 1985; and (3) Memorandum 85-16, "Guidelines for Evaluating Financial Management/Accounting Systems," dated May 20, 1985.

The requirements of these documents are briefly summarized as follows:

- Agencies are to establish and maintain a single, integrated financial management system that meets the objectives set forth in Circular A-127.

- The objectives incorporate the requirements of law and appropriate guidance of GAO, Treasury, and OMB.

- An annual review shall be performed of each financial management/accounting system and subsystem. Limited reviews are to be conducted annually and detailed evaluations are to be conducted at least once every three years. These reviews/evaluations should be made using OMB's Financial Management/Accounting Guidelines.

- Results of the reviews are to be used to develop two annual reports. A five-year financial system plan to accomplish the policies and objectives of the Circular is to be developed and included with the annual budget and management submission to OMB. Also, an annual report on accounting systems as required by Section 4 of the Financial Integrity Act is to be submitted to the President and Congress.

- Accounting systems that comply with the provisions of the Circular are to be considered as meeting the requirements of the Financial Integrity Act.

Circular A-127 provides, in accordance with Section 4 of the Financial Integrity Act, that:

- The head of each agency shall report to the President and the Congress on whether the agency's accounting systems conform with the principles and standards developed by the Comptroller General and implemented through Circular A-127,

- The report shall reflect the agency head's judgment of conformance based on the annual review carried out in accordance with Chapter V of the Financial Management/Accounting Guidelines, and

- The report shall be completed and submitted by December 31 of each year for the fiscal year ending September 30.

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The report may take the form of a letter, and should provide the following information:

- o A general statement of the nature and scope of the review.
- o A conclusion as to conformance with appropriate accounting principles and standards for all agency accounting systems, or for the individual accounting systems.
- o A list of material instances of nonconformance.
- o An inventory of accounting systems, details of material instances of nonconformance, and the plans and schedule for corrective actions. These may be placed in attachments to the report.

Details of the agency's review process and the results of actions taken to improve the overall financial management/accounting system may be included in the report.

A sample letter report is presented in Appendix G of the OMB Financial/Management Accounting Guidelines. The report may be submitted under separate cover or made part of the internal control report required by Section 2 of the Financial Integrity Act.

The planned corrective actions shown in the report should be reflected in the updated financial management system plan included with the agency's budget and management submission to OMB. The reported corrective actions should be a part of the overall agency plan and should support the policies and objectives set forth in Circular A-127.

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